


Memorandum

To: Honorable Jerome E. Horton, Chairman
Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, First District
Senator George Runner, Second District
Honorable John Chiang, State Controller

Date: January 4, 2013


From: Jeffrey L. McGuire, Deputy Director
Sales and Use Tax Department (MIC 43)

Subject: **Board Meeting, January 15, 2013**
Business Taxes Committee
Request approval to publish amended Regulation 1685.5,
Calculation of Estimated Use Tax – Use Tax Table

We request your approval and authorization to publish proposed amendments to Sales and Use Tax Regulation 1685.5, *Calculation of Estimated Use Tax – Use Tax Table* (Exhibit 1). Staff's proposed amendments account for the new registration requirements imposed by Assembly Bill No. 155 (Stats. 2011, ch. 313) (AB 155).

I. Background

Regulation 1685.5 implements, interprets, and makes specific Revenue and Taxation Code section 6452.1 by prescribing the methodology the Board uses to annually calculate the estimated amount of use tax due according to a person's adjusted gross income, and the format of the annual use tax table which the Board is required to make available to the Franchise Tax Board (FTB) by July 30 of each year for inclusion in the instructions to the FTB's income tax returns. Consumers may elect to use the use tax tables to report their estimated use tax liabilities, in accordance with their adjusted gross income, for one or more nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand (\$1,000) on their FTB returns.

As prescribed by Regulation 1685.5, the Board calculates a person's estimated use tax liability by applying a use tax liability factor to the specified Adjusted Gross Income (AGI) for the person's AGI range. Regulation 1685.5 further provides that the use tax liability factor for the calendar year shall be calculated by multiplying the percentage of income spent on taxable purchases for the preceding calendar year by 0.37, multiplying the product by the average state, local, and district sales and use tax rate, and then rounding the result to the nearest thousandth of a percent. This methodology is based upon the assumptions that California consumers spend an average percentage of their incomes on electronic and mail order purchases and that they also make an average percentage of their total purchases of tangible personal property for use in California from unregistered out-of-state retailers.

In the calculation of the use tax liability factor, the numeric value 0.37 (37 percent) represents the estimated percentage of California consumers' total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers. The 37 percent was estimated as described in the Board of Equalization Revenue Estimate, "Electronic Commerce and Mail Order Sales – Technical Documentation," December 6, 2010 (<http://www.boe.ca.gov/legdiv/pdf/e-commerce-11-10-technical.pdf>).

II. Reason for Amendment to Regulation 1685.5

AB 155 expanded the use tax registration requirements so that they apply to some out-of-state retailers, including Internet retailers, that were previously not required to register with the Board to collect and remit use tax on their sales of tangible personal property to California customers. The provisions regarding the new registration requirements became operative September 15, 2012, and are anticipated to continue to be operative throughout 2013.

While Board staff is unable to precisely determine the extent to which the new registration requirements will reduce the percentage of taxable purchases that California consumers will make from unregistered out-of-state retailers during calendar year 2013, recent registration activities, including the registration of some retailers that make substantial sales to California consumers, indicate there will be an overall decrease in the percentage of purchases California consumers make from unregistered retailers during 2013. As a result, staff believes amendments to Regulation 1685.5 are necessary to ensure that consumers who elect to report their use tax liabilities incurred during the calendar year 2013, using the use tax tables included in the instructions to their 2013 FTB income tax returns, will be paying an estimated use tax amount that reflects the new use tax registration requirements imposed by AB 155 and recent registration activities. Staff understands that a person's actual use tax liability may be higher or lower than the amount estimated using the methodology incorporated into Regulation 1685.5, but staff continues to believe that the methodology produces reasonable estimates for each AGI range and staff believes that the recommended amendment to the regulation will help ensure that the Board's 2013 estimates are as accurate as possible.

III. Estimating a New Percentage of Purchases Made from Unregistered Sellers

To determine an estimated percentage that would account for the new registration requirements imposed by AB 155, staff relied on a number of data sources including retailers' recent annual reports; 10-K reports on file with the United States (U.S.) Securities and Exchange Commission; "Estimated Quarterly U.S. Retail Sales (Not Adjusted): Total and E-Commerce," November 16, 2012, obtained from the U.S. Census Bureau; and two sets of data published by Vertical Web Media LLC: (1) *The Internet Retailer Top 500 Guide: Profiles and Statistics of America's 500 Largest Retail Web Sites Ranked by Annual Sales*, 2012 edition (hereafter *Top 500*) and (2) *Second 500 Guide: Profiles, Financial and Operating Statistics Plus Rankings of America's 501st to 1000th Largest E-retailers – The Future Leaders of E-commerce in the United States*, 2012 edition (hereafter *Second 500*).

Adjusted Total 2011 U.S. Electronic Commerce Sales

As a starting point, staff obtained electronic commerce sales reported by the U.S. Census Bureau for the four quarters of 2011 (the most recent year for which complete data is available). Staff adjusted the electronic commerce sales by: (1) adding \$10 billion to account for spending not included in the U.S. Census Bureau Data (See Regulation 1685.5 subdivision (b)(5)(B)); and (2) subtracting sales made outside of North America¹. This methodology resulted in Adjusted Total 2011 U.S. Electronic Commerce Sales of \$182,403,322,210.

Percentage of Top 1,000 Companies' Sales Made from Unregistered Companies

The data published by Vertical Web Media LLC includes, among other things, rankings of the Top 1,000 companies based on their online revenues. In November 2012, staff reviewed the Top 1,000 retailers and the Board's administrative records to determine whether or not each of the retailers were registered to collect tax in California. Staff determined that approximately 14.4² percent of North American sales made by the *Top 500* companies are made by companies that are not registered with the Board, while 78.0 percent of sales of the *Second 500* companies are made by companies that are not registered with the Board.

The total sales reported by the *Top 500* companies (adjusted for sales made outside North America) account for approximately 86.9 percent of the Adjusted Total 2011 U.S. Electronic Commerce Sales (described above). The remaining difference of 13.1 percent is attributed to companies in the *Second 500* and all other companies not in the Top 1,000 companies. For the purpose of calculating a weighted average percentage of sales made by unregistered companies, staff assumed³ that the percentage of sales made by unregistered companies included in the *Second 500* companies also represents the percentage of sales made by all unregistered companies not listed in the Top 1,000 companies.

Calculation of Weighted Average Percentage of Sales Made by Unregistered Companies

Using a weighted average (illustrated on page 4), staff determined a new estimated percentage of California consumers' total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers of approximately 23 percent.

¹ In order to make the adjustment, Research and Statistics Section staff assumed international sales reported in annual reports of the top 100 companies (of the *Top 500*) account for all significant sales made outside North America.


² Amazon.com is ranked #1 in the *Top 500* and their total North American sales account for approximately 14.6 percent of the Adjusted Total 2011 U.S. Electronic Commerce Sales. Based on a review of Amazon.com's first three quarterly reports for 2012, staff estimates that approximately 16 percent of total sales reported by Amazon.com were attributed to fees related to third party sellers and other non-retail activities. Staff assumed the revenues associated with these activities are attributed to sales made by companies with the same "unregistered percentage" as the *Second 500* companies.

³ This assumption was necessary due to a lack of data regarding the companies that are not included in the Top 1,000 companies based on their online revenues.

Calculation of Weighted Average Percentage of Sales Made by Unregistered Companies		
Line Number		
<i>Percentages of Adjusted U.S. Total E-Commerce Sales:</i>		
<i>(Weights: Sum to 100 Percent of Sales)</i>		
1	Top 500 E-Commerce Companies	86.9%
2	All Other E-Commerce Sales	13.1%
<i>Percentages of E-Commerce Sales Made by Unregistered Companies:</i>		
<i>(Are not weights; Unregistered percentages only)</i>		
3	Top 500 E-Commerce Companies	14.4%
4	All Other E-Commerce Sales	78.0%
Weighted Average: ((Line 1 (.869) x Line 3 (.144)) + (Line 2 (.131) x Line 4 (.78)) =		22.7%

IV. Conclusion

As a result, staff recommends that the Board amend Regulation 1685.5, subdivision (b)(2), to change the estimated percentage of California consumers' total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers from 37 percent to 23 percent to account for the new use tax registration requirements imposed by AB 155 and recent registration activities. Staff will continue to monitor the implementation of AB 155 to determine whether further changes are needed to Regulation 1685.5 before the Board is required to prepare the 2014 use tax tables. In addition, staff intends to review the new 23 percent estimate for the 2013 use tax tables, as data becomes available regarding the actual sales and registration activities of the top 1000 companies based upon their online revenues following the implementation of AB 155, to see if the methodology set forth in this memorandum (or a similar methodology): (1) can be incorporated into Regulation 1685.5; and/or (2) be used on an annual basis to estimate the percentage of California consumers' total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers.

Approved: 
Cynthia Bridges
Executive Director

JLM:rsww

Attachment

cc: Mr. Mike Gipson
Mr. Joel Angeles (MIC 77)
Mr. Alan LoFaso (MIC 71)
Mr. Sean Wallentine (MIC 78)
Ms. Marcy Jo Mandel
Ms. Cynthia Bridges (MIC 73)
Mr. Randy Ferris

Regulation 1685.5. *Calculation of Estimated Use Tax – Use Tax Table*

Reference: Section 6452.1, Revenue and Taxation Code.

(a) In General.

(1) Estimated Use Tax and Use Tax Table. The Board of Equalization (BOE) is required to annually calculate the estimated amount of use tax due according to a person's adjusted gross income (AGI) and make such amounts available to the Franchise Tax Board (FTB), by July 30 of each year, in the form of a use tax table for inclusion in the instructions to the FTB's returns.

(2) Who is Eligible to Use BOE Use Tax Tables.

(A) Consumers may elect to use the use tax tables included in the instructions to their FTB returns to report their estimated use tax liabilities for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand (\$1,000) on their FTB returns. However, eligible consumers may still calculate their actual use tax liabilities using the worksheets in the instructions to their FTB returns and report their actual use tax liabilities on their FTB returns. Consumers are not required to use the use tax tables included in the instructions to their FTB returns.

(B) The use tax table may not be used to estimate use tax liabilities for business purchases, including purchases made by businesses required to hold a seller's permit or to register with the BOE under the Sales and Use Tax Law and report their use tax liabilities directly to the BOE.

(3) Safe Harbor. If eligible consumers use the use tax tables included in the instructions to their FTB returns to estimate their use tax liabilities for qualified nonbusiness purchases and correctly report their estimated use tax liabilities for their qualified nonbusiness purchases in accordance with their AGI ranges, then the BOE may not assess the difference, if any, between the estimated use tax liabilities reported in accordance with the use tax tables and the consumers' actual use tax liabilities for qualified nonbusiness purchases.

(b) Definitions and Data Sources.

(1) AGI Ranges. The use tax table shall be separated into fifteen (15) AGI ranges as follows:

- (A) AGI less than \$10,000;
- (B) AGI of \$10,000 to \$19,999;
- (C) AGI of \$20,000 to \$29,999;
- (D) AGI of \$30,000 to \$39,999;
- (E) AGI of \$40,000 to \$49,999;
- (F) AGI of \$50,000 to \$59,999;

- (G) AGI of \$60,000 to \$69,999;
- (H) AGI of \$70,000 to \$79,999;
- (I) AGI of \$80,000 to \$89,999;
- (J) AGI of \$90,000 to \$99,999;
- (K) AGI of \$100,000 to \$124,999;
- (L) AGI of \$125,000 to \$149,999;
- (M) AGI of \$150,000 to \$174,999;
- (N) AGI of \$175,000 to \$199,999;
- (O) AGI more than \$199,999

(2) Use Tax Liability Factor or Use Tax Table Percentage. For the 2011 calendar year the use tax liability factor or use tax table percentage shall be 0.070 percent (.0007). On June 1, 2012, ~~and each June 1 thereafter~~, the BOE shall calculate the use tax liability factor or use tax table percentage for the current calendar year by multiplying the percentage of income spent on taxable purchases for the preceding calendar year by 0.37, multiplying the product by the average state, local, and district sales and use tax rate, and then rounding the result to the nearest thousandth of a percent. On June 1, 2013, and each June 1 thereafter, the BOE shall calculate the use tax liability factor or use tax table percentage for the current calendar year by multiplying the percentage of income spent on taxable purchases for the preceding calendar year by 0.23, multiplying the product by the average state, local, and district sales and use tax rate, and then rounding the result to the nearest thousandth of a percent.

(3) Total Personal Income. Total personal income shall be determined by reference to the most current personal income data published by the United States Bureau of Economic Analysis.

(4) Total Spending at Electronic Shopping and Mail Order Houses. Total spending at electronic shopping and mail order houses shall be determined by reference to the most current electronic shopping and mail order house spending data published by the United States Census Bureau.

(5) Total Spending on Taxable Purchases. Total spending on taxable purchases shall be determined by:

(A) Determining the percentage, rounded to the nearest tenth of a percent, of total spending at electronic shopping and mail order houses that are not included in the following categories of items, by reference to the most current retail trade product lines statistics by kind of business data published by the United States Census Bureau:

- (i) Groceries and other foods for human consumption off premises, excluding bottled, canned, or packaged soft drinks;
- (ii) Prescriptions;
- (iii) Video Content Downloads;

- (iv) Audio Content Downloads;
- (v) Prepackaged computer software, including software downloads; and
- (vi) All nonmerchandise receipts.

(B) Adding ten billion dollars (\$10,000,000,000) to the total spending at electronic shopping and mail order houses to account for spending that is not included in the spending data published by the United States Census Bureau; and

(C) Multiplying the sum calculated in (B) by the percentage of total spending at electronic shopping and mail order houses that are not included in the categories of items listed in (A) above so that the result does not include spending on nontaxable purchases, and then rounding the result to the nearest tenth of a percent.

(6) Percentage of Income Spent on Taxable Purchases. The percentage of income spent on taxable purchases during a calendar year shall be calculated by dividing the total spending on taxable purchases for that year by the total personal income for that year, multiplying the result by 100, and rounding the result to the nearest tenth of a percent.

(7) Average State, Local, and District Sales and Use Tax Rate. The average state, local, and district sales and use tax rate for a calendar year shall be the total of:

(A) The rates of the statewide sales and use taxes imposed under section 35 of article XIII of the California Constitution and the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) in effect on January 1 of that year;

(B) The statewide rate of local tax imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code, § 7200 et seq.) in effect on January 1 of that year; and

(C) The weighted average rate of the district taxes imposed under the Transactions and Use Tax Law (Rev. & Tax Code, § 7251 et seq.) in effect in the various jurisdictions throughout the state on January 1 of that year after taking into account the proportion of the total statewide taxable transactions (by dollar) reported for each jurisdiction during the fourth quarter of the calendar year that is two years prior to the calendar year for which the calculation is made. For example, the total reported taxable transactions (by dollar) for the fourth quarter of 2010 shall be used to determine the weighted average rate of the district tax rates in effect on January 1, 2012, to calculate the weighted average rate of district taxes for calendar year 2012.

(c) Calculation of the Estimated Use Tax Liability.

(1) The estimated use tax liability for the AGI range described in subdivision (b)(1)(A) shall be determined by multiplying \$5,000 by the use tax liability factor or use tax table percentage and then rounding the result to the nearest whole dollar.

(2) The estimated use tax liability for the AGI ranges described in subdivision (b)(1)(B) through (N) shall be determined by multiplying the midpoint of each AGI range by the use tax liability factor or use tax table percentage and then rounding the result to the nearest whole dollar.

(3) The estimated use tax liability for the AGI range described in subdivision (b)(1)(O) shall be determined by multiplying each range members actual AGI by the use tax liability factor or use tax table percentage and then rounding the result to the nearest whole dollar.

(d) Use Tax Table Format.

(1) The use tax table for calendar year 2011 shall provide as follows:

Adjusted Gross Income (AGI) Range	Use Tax Liability
Less Than \$20,000	\$7
\$20,000 to \$39,999	\$21
\$40,000 to \$59,999	\$35
\$60,000 to \$79,999	\$49
\$80,000 to \$99,999	\$63
\$100,000 to \$149,999	\$88
\$150,000 to \$199,999	\$123
More than \$199,999 -Multiply AGI by 0.070% (.0007)	

(2) The use tax tables for calendar year 2012 and subsequent years shall utilize the same format as follows:

Adjusted Gross Income (AGI) Range	Use Tax Liability
Less Than \$10,000	\$
\$10,000 to \$19,999	\$
\$20,000 to \$29,999	\$
\$30,000 to \$39,999	\$
\$40,000 to \$49,999	\$
\$50,000 to \$59,999	\$
\$60,000 to \$69,999	\$
\$70,000 to \$79,999	\$
\$80,000 to \$89,999	\$
\$90,000 to \$99,999	\$
\$100,000 to \$124,999	\$
\$125,000 to \$149,000	\$
\$150,000 to \$174,999	\$
\$175,000 to \$199,999	\$
More than \$199,999 -Multiply AGI by __% (.000 __)	